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STATE FOR EB/IFD/OMA
TREASURY FOR DO/IDD AND OUSED/IMF
SECDEF FOR USDP/DSAA
PASS EXIM FOR CLAIMS -- EDELARIVA
PASS USDA FOR CCC -- ALEUNG/DERICKSON/KCHADWICK
PASS USAID FOR CLAIMS
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SUBJECT: PARIS CLUB - JUNE 2005 TOUR D'HORIZON

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SUMMARY

1. (U) Following are summaries of country discussions during the June 15, 2005 Paris Club session. Country negotiations will be reported septels. The Paris Club's President, Jean-Pierre Jouyet, chaired the session. Secretary General (SecGen) Emmanuel Moulin represented the Secretariat. The next session of the Paris Club is a special meeting to discuss Nigeria scheduled for June 29, 2005.

12. (U) NOTE: INDIVIDUAL CREDITOR POSITIONS REPORTED IN THIS MESSAGE SHOULD BE TREATED AS "PARIS CLUB CONFIDENTIAL" AND NOT/NOT DISCUSSED WITH DEBTOR COUNTRY REPRESENTATIVES, NOR WITH NON-PARIS CLUB PARTICIPANTS.

13. (SBU) Discussed in this session:

TOUR D'HORIZON:
Afghanistan -- IMF update / bilateral agreement
Algeria - report from Secretariat / bilateral agreement
Angola - report from the Secretariat (Brazil)
Argentina -- Upcoming negotiation (Israel)
Burundi -- IMF update / decision point
China -- possible accession
Dominican Republic -- comparability of treatment
Grenada -- IMF update
Indonesia -- MoU, bilateral agreements
Iraq -- IMF update / bilateral negotiations
Malawi-- IMF update

Nigeria -- treatment proposal
Paraguay -- review of arrears (Belgium)
Peru -- prepayment proposal signing
Russia -- debt prepayment / bilateral agreement (France)
Sao Tome and Principe -- IMF update / financing assurances
Serbia and Montenegro -- IMF update / second phase of the AM
Sri Lanka -- MoU signing
Zimbabwe -- arrears

METHODOLOGY:

Additional bilateral debt relief beyond HIPC

Breakage costs

Status of Brazil

14. (U) ACTION/FOLLOW-UP/UPCOMING ITEMS

June 29 special meeting--Nigeria proposal

AFGHANISTAN

15. (SBU) The IMF reported a request to extend the SMP in Afghanistan until March 2006. Preparation for a PRSP is underway and the IMF would be open to a clear discussion of a PRGF if the authorities request. The GOA has performed strongly under the current SMP, meeting all benchmarks except reconciliation of external debt. The macroeconomic outlook for the near future is favorable. The principal challenge is increased spending pressure. The GOA has had difficulty in contacting creditors and may ask the IMF for help in contacting non-PC creditors.

16. (SBU) The IBRD added that the security situation is degrading especially in light of approaching September elections. Half of the funding to the GOA is in performance grants. There is also a reconstruction trust fund, which has received \$850 million from donors in three years. From these funds, the IBRD has dispersed \$235 million for the GOA operating budget.

17. (SBU) Russia reported that the progress on bilateral debt resolution with Afghanistan has been difficult due to mistrust between accounting agencies. Russia is the largest creditor to Afghanistan. The GOR hopes to resolve the issue by the end of

12005. While the problem is mainly bilateral, Russia prefers to use the Paris Club channel and its standard procedures. On the subject of debt treatment for the GOA, the situation is far from 1997 methodology. Germany remarked that it is in favor of an IMF accord but would need a stronger basis. The GOG proposed further Paris Club negotiation in due time.

ALGERIA

18. (SBU) On Algeria/Russia relations, a bilateral accord calls for the reimbursement of Algerian debt to Russia beyond the 10% debt swap ceiling. The Secretariat emphasized the importance of a buyback at market values: Algeria should not anticipate which creditors would participate in a buyback before confirming the offer.

ANGOLA

19. (SBU) Brazil had been invited to talk about its loans to the GOA, but was not present. The IMF reported that discussions on a SMP resumed in April. The framework has been established but no agreement has yet been produced, although negotiations are still open. A delegation may go to Washington, D.C. in July to continue this process. The IBRD noted that it expects to conclude details of a PRSP in July. The agency has monitored transparency in accounts and public resource management. Other SMP preparatory actions include workshops on oil revenue management. The IBRD will translate the finance account review with a wide distribution to take place in August.

110. (SBU) The Secretariat reported that it only had vague information on the Brazilian loan to Angola. It also clarified that the credit from Israel in 2003 was private. Denmark asked if the Secretariat intended to make a data call. The Secretariat has encouraged Angola to seek an accord with the IMF.

111. (SBU) Belgium asserted that current Angolan policies are all based on oil/petroleum. Germany stated that Angolan action to get new money (such as financing for oil projects) is positive, as it stabilizes the financial situation and thus the ability to pay off debt. This action is therefore not against PC rules and is moreover the decision of the country. Spain added that new loans might help the GOA, making it less dependant on the PC. However, loans and bilateral agreements would decrease the incentive to go to IMF for a SMP. Thus, the PC creditors should grant debt relief on the basis of an IMF SMP. Spain characterized the current situation as an unstable equilibrium, mixing international and bilateral aid.

ARGENTINA

112. (SBU) The IMF reported an extension of \$1.5 billion to the GOA. Discussions on Argentina will resume after an Article IV review on June 22, after which the IMF will decide what program should go forward. The IMF is not conducting a program negotiation but rather a forecast consultation. The IBRD noted that Argentina should be processed under a streamlined method for IBRD loans but GOA economic programs have produced concerns. As a result, examination of programs continues on a case-by-case basis. The World Bank reported that Argentina continues to make net repayments to the IBRD with a recent payment of \$400 million. The GOA is facing \$17 billion in arbitration claims, largely before ICSID. Some members of the GOA have argued that arbitration awards against Argentina are unconstitutional unless the Argentine courts review them and approve that they are consistent with public policy.

113. (SBU) The Secretariat stated that the scenario presented by the GOA (including a cancellation of arrears) is unrealistic. The scenario shows a currently unsupportable debt burden and plans to reduce debt to zero in 2009. Overall, there is a gap between the views of the IMF staff and the Argentine authorities. The GOA does not share IMF staff views of policy impacts and changes.

114. (SBU) The Italian delegation had a question on the place of holdouts and requested hard data on a forward-looking strategy.

BURUNDI

115. (SBU) The IMF reported on a mission visit during mid-May. The mission found fiscal programs to be on track under the PRSP and Cologne methodology. A financial gap exists due to the demobilization. A decision point document will be issued July 113. The IBRD had nothing to add and so the Secretariat opined that the decision point would be reached.

CHINA

116. (SBU) The Secretariat noted that the Paris Club cannot ignore China and must consider PC/China relations.

DOMINICAN REPUBLIC

117. (SBU) The IMF reported a Mission visited the DR for the first review and to discuss the Stand-By and Article IV. Talks continued in DC on fiscal policy and structural reforms. The authorities are committed to implementing their program, and are moving along at a reasonable pace on their external financing strategy. The GoDR is considering re-opening the bond exchange, despite the already high participation rate, to reduce their debt by another USD 14 million. Negotiations with non-Paris Club creditors are advancing. The IBRD said its Board had discussed a new country assistance strategy on May 9.

118. (SBU) The Secretariat said bilateral agreements awaiting signatures include France, Japan, Germany, and the USA, so the GoDR wants an extension. Those creditors all reported good progress in their bilateral agreements, although Japan asked the Secretariat to remind the GoDR about 2.7 million USD arrears

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which had accrued as of May 20. The Secretariat reported that on comparability of treatment (CoT), the London Club and the GoDR the day before had signed an agreement. The Secretariat presented a working paper in which it concluded that CoT is being met, and noted that debt reduction may not be needed for 2006-7 because the GoDR is close to eliminating its financing gaps. The President noted the consensus to grant an extension until August 30, with a target date of September for the negotiation on debt rescheduling for payments due in 2005.

GRENADA

119. (SBU) The President noted significant arrears, totaling USD 27 million, to countries including Belgium, France, USA, UK, and the Netherlands. The IMF reported that GoG authorities say they are continuing talks with private creditors and with donors. An Article IV discussion is set for the Board on July 13. The GoG is eager to cooperate, but has not advanced very far. The IBRD reported its programs in Grenada are on track. Russia noted one claim not included in the data call, and the USDEL promised to double-check its figures as well.

INDONESIA

120. (SBU) The Paris Club discussed the progress on a MoU for Indonesia. The IMF informed the PC of ongoing Article IV and past program monitoring. The May staff report will highlight fiscal banking practices and post-tsunami reconstruction efforts as well as coordination of relief. The IBRD added that reconstruction agency and a \$500 million trust fund are supporting Indonesian relief efforts. An IBRD update is in process and should be out by the week of June 20.

121. (SBU) Earlier bilateral issues included outstanding financial obligation to Germany and the UK - both situations were bilaterally resolved before the June Tour d' Horizon. The US announced that it had signed a bilateral agreement with Indonesia. Finland noted that it has not signed a bilateral with the GOI, but the MoU would not cover the sums involved. Japan noted for the record that as a small creditor, it sees no problem with the terms of the MoU.

IRAQ

122. (SBU) The IMF reported that it had concluded discussions with Iraq, marking the first Article IV consultation with the nation in twenty-five years. The IMF views this as an important step in normalizing Iraqi relations with the international community. Although there are some delays on structural reforms, the macroeconomic situation is under control. The IMF also noted that the Iraqi Finance minister would like reforms. Iraq is generally on track with its EPCA reforms. Progress had been made in contacting PC and non-PC creditors. The authorities request an extension to sign bilateral agreements.

123. (SBU) The PC Secretariat announced that it is in contact with the Iraqi cabinet. The GOI has made progress since February, contacting non-PC creditors (48 states) based on new accords. The Secretariat provided an update on the bilateral agreements of these non-PC creditors with Iraq. Although Italy requested that the list be distributed, the confidential nature does not allow the PC to provide a copy of this list.

-- Malta announced \$7 million in credit to Iraq
-- Argentina has small claims
-- Greece presents a more problematic case as the military credits involved are subject to a 2003 decision
-- China does not recognize Iraqi authority
-- The Secretariat must verify Libyan credits--contact with the GOL established
-- Bosnia, Croatia, Luxembourg, Mexico, Lithuania do not have sovereign debt. No contact has been established with Bosnia and

Croatia. The Czech Republic is an important creditor, but the GOC has not yet declared its claims. The PC also does not have information for the Gulf States (Saudi Arabia, etc).
-- The Maghreb (North African former French colonies) countries have no clear interlocutor, and Egypt prefers direct contact with the GOI instead of the PC channel.
-- Vietnam is a particular case as it is both a creditor and a debtor to Iraq.
The Secretariat reiterated that it has offered its assistance in establishing bilateral contacts.

124. (SBU) Spain addressed the interpretation of the AM, reminding members that the Paris Club had agreed that a letter to the GOI (sent in May) should be interpreted according to the spirit in which it was written. Spain requested that this previous consensus should be specified.

MALAWI

125. (SBU) The Secretariat noted positive developments in Malawi's debt sustainability. In September 2004, the authorities requested a SMP. The GOM has made satisfactory progress, tightening fiscal spending and implementing structural reforms. The IMF is requesting a retroactive extension in order to continue a PRGF with Malawi. (Note: The PRGF expired in December 2004 after only one review due to inadequate implementation. End note.) The IMF proposed the Paris Club send a letter to the Board for this extension.

126. (SBU) The IMF began to negotiate a potential PRGF in February 2005, and with creditors' approval will present this plan to the Board in July. The program would require fiscal efforts to reduce domestic debt (after a 25% crop failure) as well as modifications to the 2005-2006 budget & pension systems. Once approved, the PRGF could be started in 2006 for three years. Malawi only has small amount debt to the IBRD.

NIGERIA

127. (SBU) The IMF staff report on Nigeria will be issued in July. Concerning Nigerian macroeconomic policy, the IMF found that an appropriate act was signed in April, relaxing fiscal policy and minimizing risk for the GON. This act contains measures to contain fiscal spending and maintains a monetary policy consistent with 7-9% inflation. The most recent Article IV consultation and DSA found Nigerian debt to be sustainable at current oil prices but vulnerable to an oil price shock. The Secretariat stated that with Nigeria on the reform path, the PC

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could either let the country go its own way, or recognize the current problems with the status quo and give assistance.

128. (SBU) The GON has expressed a desire for a non-financial arrangement with the IMF. The new instrument proposed is a PSI (policy support instrument). This tool is not yet approved and will be considered by the IMF executive board on July 6 (note: the IMF subsequently pushed back the date, as yet unspecified). The PSI was also submitted last year for another country but not accepted at that time. This tool is designed to aid countries without financial need that would welcome an assessment of their policy and budget by the IMF. . The program would entail an IMF endorsement and monitoring of programs designed by authorities.

129. (SBU) The IBRD clarified that Nigeria has been reclassified under IDA classifications: the country fits the criteria of low GDP per capita, yet is not eligible for IDA grants (under Article 14). Moreover, Nigeria does not have an international credit rating from a major international institution. The IBRD reported the presentation of a new country assistance strategy to the Board June 26 by UK Aid (DFID) and IBRD staff.

130. (SBU) The Secretariat announced the structure of principal PC claims on Nigeria: the UK is the principal creditor (26%), followed by France (21%), Germany (18%) and the US (3%). The current repayment profile (as of Dec 2000) shows debt unsustainability until 2019, with debt then stabilized around \$2 billion. Following a positive evolution in Nigerian finances, the GON has submitted an informal proposal to use oil windfalls to fund an exit treatment. Oil revenues would cover a buyback of Paris Club debt at a 75% discount. The Secretariat stated that the political context for such a proposal is favorable; with a Presidential election in 2007, current internal polarization on debt, and an ambitious reform team taking on structural and economic reforms in place since 2003. Also, the GON has made efforts to normalize relations with PC by means of allocation payments and increased transparency. Overall, the proposal is subject to a unique and short window of opportunity because of possible changes in oil prices, pressure on the finance minister and upcoming elections. The Secretariat asserted that there is no alternative solution in normal Paris Club treatment options. However, elements of the Nigerian proposal conflict with PC rules. First, the PC cannot offer a buyback, as Nigeria is not a graduate of Paris Club treatment and is in partial default.

Nigeria has not been eligible for HIPC or Naples terms. Accepting the current proposal would provide no incentive for the GON to implement good long-term policies. Secondly, the level of discount is not justifiable. It should be set according to market prices. Nigeria has been reclassified as IDA-only, making it eligible for Naples terms. The Secretariat suggested a Naples stock treatment. Statistics provided by the Secretariat showed that faced with a permanent petroleum shock, the GON debt ratio would be unsustainable from 2018. Even with a 67% debt reduction on PC claims, debt unsustainability would only be pushed back to 2025. A treatment of Nigeria would also provide an opportunity to meet MDG.

131. (SBU) The Secretariat noted that the current debt situation of Nigeria is highly vulnerable; even prudent country-specific scenario shows probable debt unsustainability. Under its proposal, the GON would repay all arrears given a substantial debt reduction. This repayment would occur immediately with creditors receiving 40% claims in cash over six months (USD 4.48 billion). A possible architecture for this offer includes:

- Signing a PSI with the IMF;
- Clearing of all arrears plus late interest (USD 5.8 billion) by Nigeria, plus payment of "leveling up" obligations to eligible creditors (USD 1.75 billion);
- After successful review under the PSI at six months, payment by Nigeria of its Post-COD debt at par and (\$367 million) and delivery by the Paris Club of a second phase of debt reduction equal to 37 percent of the outstanding debt stock;
- Buyback by Nigeria of the balance of debt owed to creditors at a 41% discount;
- Total payments by Nigeria would amount to \$12.4 billion under the scheme.

132. (SBU) The proposed PC treatment of Nigerian debt depends on the imminent creation by IMF of a new monitoring instrument (PSI). The Secretariat noted that a PSI as a basis for a debt treatment is a significant move for the PC. However, the Secretariat also noted that a PSI would be strong on

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conditionality (like a SBA or a PRGF).

133. (SBU) The UK supported the proposal with IMF help, viewing it as a way to move forward and signal support of the GON. There would be gains for all: Nigeria would receive debt relief and creditors would receive cash payments within 6 months. The PC proposal is a fair, sustainable solution.

134. (SBU) The USDEL argued that the plan constituted a major advance; Nigerian acceptance of a serious monitoring arrangement with the IMF implied serious continued commitment to reform efforts and removed a major obstacle to being able to agree to a debt deal. In the US view, the Secretariat's presentation had adequately addressed issues of precedent and principle presented by the notion of a debt workout for Nigeria, and the US was exploring ways to enable its participation in such a deal. .

135. (SBU) Germany announced that it would go along with the proposal but has some reservations. The proposal represents new ground and must be approached carefully with further IMF exploration. Germany reminded the PC members that for all previous arrangements with Nigeria (2000 arrangement as the most recent), Nigeria had never drawn credits. A point of comparability (CoT) was highlighted, noting that the private sector would notice this charitable move. The GOG's final position is to accept the plan only if the GON accepts it.

136. (SBU) Italy subscribed totally to the Secretariat's proposal, as it treats both economic and political issues. The PC creditors should take this opportunity to be reimbursed or the oil windfalls will be spent domestically. The GOI acknowledged the unknown element of a PSI but suggested that it be subject to evaluation in future, after being monitored in action. Overall, accepting the request from Nigeria would show the capability of the PC to aid large countries.

137. (SBU) Spain welcomed a flexible, pragmatic solution but had doubts about this proposal. The Spanish delegation questioned the 40% figure and the contradictory package of debt relief with a buyback. Other Spanish concerns related to the rapid timetable of the proposal. Spain was concerned that rapid action might convey that the PC can be subject to debtor time constraints and that this timetable was generally unrealistic in comparison to Russian and Peruvian buyback proposal implementation time. The GOS could not take a position and requested a working paper to study. Denmark shared the Spanish point of view, suggesting a written proposal.

138. (SBU) The Netherlands reacted negatively against the proposal, stating that the creditability of PC and its process was at stake. Such action by the PC might hurt the private sector. The Netherlands declared that it would be difficult to accept the proposal, as it was never formally approached and had no mandate to accept one without profound explanation. The Netherlands criticized the G-7 members of the PC for excluding the rest of the club from the preliminary Nigeria discussion, stating that this is the second incident of G-7 members working

on a PC issue without all PC members' participation. The importance of transparency in PC practices was asserted.

139. (SBU) Austria remarked that the proposal was a political decision that could change the PC underpinnings. The Austrian delegation also expressed doubts that Nigeria could now offer USD 12 billion when previous offers did not surpass USD 1 billion. Time concerns were also voiced, with Austria suggesting that a mandate in July would be premature.

140. (SBU) Australia clarified that it was not a Nigerian creditor but had interests in the procedure and nature of proposal as a small creditor in the Paris Club. The delegation drew parallels between Indonesia and Nigeria, highlighting that Indonesia is important to Australia. As a non-G-7 member, Australia echoed the criticism of the Netherlands, saying that the PC is not a two-track process - the non-G-7 countries are not there to rubber stamp G-7 proposals. Australia proposed a working paper treating possible changes to the PC structure, including ad-hoc ministerial meetings and a politicization of the PC and debt relief. Australia also cited the hybrid nature of the proposal (debt treatment and buyback) and asked why the Evian approach was not considered. The only justification Australian perceived for the proposal seemed to be the current oil prices.

141. (SBU) Norway and Sweden echoed the concerns of Australia. Norway expressed doubts that the proposal would be in line with the Evian approach. The Norwegian delegation also cautioned the PC against using a new combination, especially an exit treatment for country that never "entered". Sweden asserted that the proposal was highly political and the situation held the same problems as that of Iraq.

142. (SBU) Switzerland asked if solid economic analysis existed for the proposal, or if it was purely political. The delegation suggested an analysis of the IMF's PSI and a projection of buyback conditions. Switzerland also requested a working paper with market reference rates.

143. (SBU) Belgium noted that it favors a constructive solution but would need a precision on conditionality as well as the statute and role of a PSI. The Belgian delegation asserted that it favors CoT regarding third parties and stated that the PC should look at different categories of debt and the risk of precedent in this case.

144. (SBU) Canada stated that while it is not involved with Nigeria, it supports this proposal because Nigeria is the key to success in Africa. While Canada recognized the concerns of other members, it defended the adoption of an appropriately designed PSI tool. Canada saw no problem in granting a debt treatment to Nigeria.

145. (SBU) Russia and Finland both stated that the case is complicated and may need further consideration. Russia announced its supports the idea because the package makes sense.

146. (SBU) France recognized that this proposal would be crucial for population stability in Nigeria and the surrounding region. PC action in this country could be a way to achieve Millennium objectives. However, the French advocated an equitable solution in line with the PC rules. The proposed Nigeria debt treatment would be the worst solution due to a risk of precedent. The French delegation mentioned the possibility of also using Naples terms in Yemen because of liquidity there.

147. (SBU) The Secretariat noted the questions and disagreeable aspects of the proposal and confirmed the importance of PC credibility. Moulin expressed his personal point of view that the form and substance of a plan are both essential. However, in this case the opportunity should be seized with content taking precedence over form. In order to reach a consensus later, the President directed the Secretariat to prepare a working paper and scheduled a special meeting on Nigeria for June 29.

PARAGUAY

148. (SBU) The IMF reported it had concluded its fourth review on March 28. A mission visited in April for the fifth review. It has no information about arrears. Belgium said it had asked for Paraguay to be put on the agenda because it has not paid late interest. After reaching an accord to split the difference, Belgium still has not been paid. Germany said Paraguay had had some arrears, but they were cleared. France reported it had had arguments about late interest too, but finally had been paid. The President directed the Secretariat to prepare a letter on the arrears.

PERU

149. (SBU) The GOP submitted a proposal regarding the reimbursement of all non-ODA maturities from 2005-2009. Both the IMF and the IBRD supported the proposal. The IBRD believed it would be a good move for external debt management and fiscal

control. The Secretariat added that the accord is unique; if accepted, it could consolidate the 1993 accord and offer creditor countries up to \$2 billion. Japan asked to insert the words, "when necessary" under Article IV-1 as a signing condition. Spain was still waiting on the word of the appropriate minister to sign. The Secretariat decided to wait to send the letter.

RUSSIA

150. (SBU) On the offer of debt prepayment, the Secretariat described 2 options: signing a bilateral letter of implementation and the payment of the first installment (35.3%) on July 15, or setting August 20 as the date to sign the letter and pay (35.5% + x%). The Secretariat noted that the decision to participate had to be taken at this meeting.

151. (SBU) Regarding bilateral debt issues between France and Russia, a standard letter was prepared in English, with the French version to be signed later. Italy commented that the GOI would not sign this letter; it should be addressed only to the GOF and GOR.

SAO TOME AND PRINCIPE

152. (SBU) The IMF reported on the June 2 change in government. It has put the PRGF on hold until the new government commits to it. The new Prime Minister is a former central bank governor, which gives the IMF reason for optimism. It is worried about wage increases larger than agreed. The World Bank said its Board discusses a new country assistance strategy on May 21. USD 10 million was made available for budget support. The main issue precipitating the change in government was the lack of transparency in the bids for the offshore oil blocks. The UNDP has asked that the contracts be reviewed. The World Bank has offered its assistance. The Secretariat reported it has offered to meet the new government officials in Paris.

SERBIA AND MONTENEGRO

153. (SBU) The IMF reported its arrangement was to expire in May 2005, so it granted an extension until December 31, 2005 to allow time to complete its review. The Board meeting is set for June 129. The fifth review, as a result, will not be the last review. A sixth review will take place for the July-November period. The authorities claim to have cleared arrears to Russia, but have not completed their bilateral agreements with Italy and Japan, and are requesting a suspension of 60 percent of their interest payments.

154. (SBU) The World Bank reported that structural reforms have progressed. When Serbia rejoined the Bank, it came in with an exceptional IDA allocation. The Bank expects IBRD lending to begin again as Serbia rebuilds its creditworthiness.

155. (SBU) The Secretariat noted the situation is now different than when it earlier rejected an extension request, as the IMF has granted an extension. It now favors a Paris Club extension, as the capitalization of late interest is critical to the success of the IMF program.

156. (SBU) Germany supported the extension request. Japan expressed some discomfort, as officials just asked the Japanese Cabinet for approval of the bilateral agreement, and now will need to return to the Cabinet to approve the extension. Italy said it is finalizing its bilateral agreement, and is OK with an extension. Russia said Serbia has managed to pay the bulk of its arrears (except for USD 30 thousand, which does not present an obstacle to the extension), but it will need technical approval before it can sign off on the extension. Other creditors agreed to the extension, but Austria raised a point that the figures are off, which the Secretariat confirmed is due to a data split between Serbia and Montenegro. Sweden inquired about the resulting date of debt reduction, and the Secretariat replied that the date should not be the original date in the agreed minute (AM), but the date that they comply with the terms in the AM to simplify calculations. The President noted the consensus to hold off on the extension request until all creditors could agree to it, and the Secretariat noted that it could wait to send a letter but would need to send it before the AM terms expire.

SRI LANKA

157. (SBU) The GOSL signed the MoU, thanking the PC creditors for their assistance. The accord is designed to help SL get over the tsunami disaster, providing the GOSL with a margin of maneuver

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for its own reconstruction. The GOSL stated that a special committee has been created for post-tsunami reconstruction development. The committee is committed to practical and efficient use of monetary assistance.

ZIMBABWE

158. (SBU) The IMF reported that the economic and policy performance of the GOZ had worsened, especially since the last election. Problems include water/power cuts and security concerns. The concern is that without action, further deterioration will occur. Currently, near term structural reform seems difficult. Under an Article IV consultation, the IMF will proceed with a review of obligations and address the complaints about Zimbabwe actions at its August 1 staff meeting. The IBRD added that expulsion by IMF automatically entails exclusion by the WB in a delay of 2-3 months.

159. (SBU) The Secretariat informed the PC that the Zimbabwean Ministry of Finance had seized the Secretariat (???). The GOZ was contesting seizure by the Bank of Tokyo. A letter to Zimbabwe was proposed and then defeated, as the Secretariat is not in the process of negotiation with GOZ. Germany stated that action to recover loans was being carried out by a private bank (KFW) and not the GOG. (KFW is not a public bank but an export finance institution. Germany added that a judicial case to press for repayment is the legal right of creditor. The Netherlands concurred that a creditor should use all legal means for recuperation of credits.

METHODOLOGY

ADDITIONAL DEBT RELIEF BEYOND HIPCS:

160. (SBU) The President noted current efforts to provide greater levels of debt relief, and discussed the Working Paper prepared by the Secretariat canvassing current practices. The IMF had no comment on the substance, but did note its desire to use the data for its own progress report. The Secretariat presented its Working Paper, outlining various options.

161. (SBU) Norway said it has supported the German proposal, but with the caveat that relief not address old debt. It still strongly supports additional relief. If the IFIs can cancel concessional claims, countries should do so too.

162. (SBU) Russia said it would make its position known in July. Switzerland said it had no instructions, but probably would support additional relief. The Netherlands said it would not change its position. The Paris Club does not touch commercial debts, and should not play with cutoff dates, but France and Germany can change their domestic legislation to provide additional relief if that is what they desire. Belgium concurred. The Netherlands is in favor of additional debt relief if needed from a sustainability point of view. Sweden was reluctant to give a guarantee of support without a proposal in writing. The Swedish delegation also added that the PC should treat each country according to its needs and move each cut-off date case-by-case. Sweden would be in favor of relief beyond Cologne terms if necessary, but would find it difficult to act retroactively, as it does not want to send back payments.

163. (SBU) Spain agreed to make additional efforts for bilateral debt relief, but questioned the applicability of this proposal to multilateral debt relief. Spain requested a working paper and debate on the subject of multilateral debt relief. Germany noted that after preliminary discussions, a consensus would be difficult to achieve, but the GOG hoped that the PC would reach an agreement. Germany added that the proposition is in the spirit of Cologne terms and clarified that the debate had only centered on non-ODA countries.

164. (SBU) The UK and Finland are in favor of the proposal, which demonstrates increased generosity. Denmark, Italy and Austria are already using this policy and support the PC use of it. Canada had already forgiven eligible HIPC debt and agreed with the proposal terms. Japan would also agree to 100% cancellation of ODA debt and even cancel 100% non-ODA pre-CoD. The USDEL also fully supported the measure, but suggested that the Secretariat provide a matrix in response to the data call.

165. (SBU) The Secretariat clarified that this initiative would not be included in the Agreed Minutes but instead would be put into practice bilaterally. The President noted the consensus to continue the discussion regarding multilateral debt relief and problems with the current bilateral proposal at a later date.

BREAKAGE COSTS:

166. (SBU) The Secretariat reviewed its findings that no creditor finances breakage costs directly. The Secretariat noted the risk that if clauses for breakage costs are included, this creates the risk of not being able to do prepayments at par, which would mean only buybacks are possible. As seen from the recent Russian negotiation, that creates political problems, and unduly limits the Paris Club.

167. (SBU) Switzerland stated that breakage costs could deter a creditor from participation, suggesting that negotiation of bilateral accords outside the PC would better accommodate this idea. The idea of incorporating breakage costs is not in a PC agreement, but could possibly be a useful tool.

¶168. (SBU) Belgium suggested the refinancing of accords outside the PC, consolidating them in this way. The Belgian delegation also insisted on the voluntary nature of creditor participation in agreements, stating that no creditor should be forced to participate in a buyback or prepayment.

¶169. (SBU) Austria and Germany were opposed to the idea of introducing breakage costs clauses. Germany noted that this clause would reduce refinancing by governments/government agencies. Moreover, a prepayment would not work if breakage costs were attached to the agreement. Germany added that adding breakage costs is a commercial bank practice, not a government practice.

IDA-ADMINISTERED EU LOANS

¶170. (SBU) The Secretariat offered to prepare a paper on the subject and circulate it in July or September. The Secretariat also announced that it could work with the European Commission. The total debt equaled 59.56 million euros as of December 31, 2004). The President said the question is what to do with debtors that have already reached completion point, and suggested a letter of cancellation might be best.

¶171. (SBU) The IBRD reviewed its credit administration program, which operates outside of the IDA envelope. The IBRD reminded PC members that the program is still administered according to original guidelines but the IBRD is open to suggestions. PC members were advised to instruct the IDA administration on how to carry out debt cancellations and what do between decision and completion points. It also asked for PC input on dealings with countries that have passed the completion point before or have continuing multilateral debt. The goal of the program has been to regularize situation post-completion point. The current operation involves semi-annual payments (1 May, 1 November), which are converted in currency proportionate to the principal as well as a service charge of 0.75% (which becomes IBRD income).

¶172. (SBU) Denmark argued for the simplest procedure possible. Another solution would be a special addition to the HIPC trust fund. Denmark requested a proposal in writing.

BRAZILIAN PARTICIPATION IN THE PARIS CLUB

¶173. (SBU) The President noted the size of Brazil's economy, and its associate membership status since 1972, but said its recent behavior put into question its solidarity with the Paris Club. Examples cited included a lack of participation in recent accords and discussions (Iraq, Nicaragua, Zambia) under the pretext of internal legal reasons. However, the Secretariat reminded the PC members of Brazil's status as an important partner and closest ad-hoc member. A draft letter regarding the role of Brazil internationally and the possibility of giving Brazil full-member status in the PC were debated.

¶174. (SBU) The IMF noted that Brazil is a creditor to ten HIPC countries. Belgium cited cases from the 1990s and highlighted that the PC could now use Brazil's own arguments in those situations against them. Germany questioned the validity of the point about Iraq in the draft letter. Regarding the letter, the German delegation proposed a change of wording to reflect that Angolan credits are different than HIPC and Iraq. Similarly, Norway proposed giving the letter a more neutral tone.

¶175. (SBU) The UK expressed its strong interest that Brazil remain an associated member and partner of the PC. The UK had no problem with the thesis of the letter, but rather with its tactics. The UK also suggested that the PC give careful thought to full membership status for Brazil if the country fully commits to the HIPC initiative.

¶176. (SBU) Spain explained that recent contacts with Brazil demonstrated that the country acted more like a debtor than a creditor; the PC would rather have the country in the camp of the creditor nations. Yet, Spain agreed that permanent member status for Brazil is worth considering; this should not be mentioned in the letter, but the subject of future PC discussions. Having Brazil as a full member would diversify the PC, giving it a Latin America representative.

¶177. (SBU) The USDEL concurred that the letter would be a good idea and looked forward to hearing the views of other PC members. The USDEL proposed simplifying the vague phrase "confident relations" to clearly indicate the importance of the PC solidarity principle. The Netherlands also affirmed the importance of Brazilian participation but maintained that full members must adhere to all PC rules.

¶178. (SBU) Japan agreed with the letter and asked about the role of other Portuguese-speaking nations (Portugal and Angola). Belgium responded that the EU countries have pressured Portugal to join as measure of solidarity.

¶179. (SBU) Canada questioned the effectiveness of a letter, citing the risk of alienating Brazil. The Secretariat reminded the Paris Club that the letter was intended to remind Brazil that it is an important PC partner, not to reproach the country's

behavior. The President noted the suggested modifications, and directed the Secretariat to circulate a revised version before sending.

This message was cleared by the Head of Delegation.

Minimize considered.

STAPLETON